

CHAPTER 8

COMMUNITY DEVELOPMENT BLOCK GRANT ECONOMIC DEVELOPMENT PROJECTS

I. OVERVIEW

The purpose of this chapter is to assist local governments and local development organizations implementing economic development projects funded by the Community Development Block Grant – Economic Development (CDBG-ED) Program. Because economic development projects involve both the private and the public sectors, clarification of the federal and state requirements that are applicable to each private and public sector participant is necessary. Many requirements that will apply to the local government, as a public entity, will not apply to the private sector for-profit or nonprofit entity. In addition, some requirements that may apply to one type of economic development project may not apply to another project because of the different activities being conducted.

To a private businessperson, many of the federal regulations associated with the program may seem more applicable to traditional public sector projects. However, it is the responsibility of all CDBG-ED recipients to comply with applicable federal and state laws, executive orders, and regulations affecting their projects. The major federal requirements that may apply, as listed in the CDBG Certifications for Application, will become specific conditions of the grant contract between the Montana Department of Commerce (MDOC) and the local government. Certain requirements will also apply to the agreement between the local government and any business or agency that will receive CDBG-ED assistance through a loan or grant.

Local governments should carefully review these requirements and consider their potential impact when implementing their CDBG-ED project. These laws can affect the costs and complexity of the project and the schedule for completion.

Local governments and businesses should also be aware that **it will take at least two months or longer after the decision to award funds has been made before they will actually receive any funds**. This delay occurs because several activities must take place, called “start-up conditions”. For example, the contract between the local government and the Department must be prepared, the local government must conduct a review of environmental factors, and all the details for assuring proper management of the project and the expenditure of federal funds must be finalized.

NOTE: It is absolutely essential that the applying local government and the assisted business not incur ACTIVITY costs or obligate funds, which are intended to be reimbursed with CDBG-ED funds prior to the date that all contract start-up conditions (Section 14, Special Conditions, of the contract) including signing the loan agreement if applicable, are satisfied by the local government and approved in writing by the MDOC. The local government may incur ADMINISTRATIVE costs as directed by the Department, from the date of CDBG-ED award.

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II. APPLICABLE REQUIREMENTS

The following state and federal requirements are discussed in more detail in the appropriate chapters of the CDBG Program Grant Administration Manual. Each of the following sections discusses the requirements of each chapter in terms of how the requirements may be different for economic development projects.

A. Chapter 1 - Project Start-up

All of the requirements discussed in Chapter 1, Project Start-up, apply to all economic development projects. The local government must complete all of the steps outlined in the chapter before CDBG-ED funds will be made available for drawdown. Shortly after the funding award decision, the CDBG-ED program will notify the local government of required start-up conditions.

B. Chapter 2 - Environmental Review

Local governments must follow all of the applicable steps in this chapter and receive either a **written** release of funds or a concurrence with a finding of exemption from MDOC before CDBG-ED funds can be released. Completion of the environmental review checklist must be initiated soon after CDBG-ED funds are awarded since it may take one month or more to complete the environmental review. Different projects will require varying levels of environmental review (see **Exhibit 8-H** for a flowchart describing the process). Many projects involving the purchase of equipment or the provision of working capital will come under 24 CFR Part 58.35(b)(4), (Finding B) which states in part:

. . . that the following categorically excluded activities would not alter any conditions that would require a review or compliance determination under the Federal laws and authorities cited in §58.5. When the following kinds of activities are undertaken, the responsible entity does not publish a NOI/RROF or execute a certification and the recipient does not have to submit a RROF to HUD (or the State) except in the circumstances described in paragraph (c) of this section . . . The recipient remains responsible for carrying out any applicable requirements under §58.6 . . .

. . . Economic development activities, including but not limited to, equipment purchase, inventory financing, interest subsidy, operating expenses and similar costs **not associated with construction or expansion of existing operations** . . . (*emphasis added*)

See **Exhibit 8-H.5** for a sample letter for a finding of “Categorical Exclusion” under 24 CFR Part 58.35(b)(4).

If a project involves expansion of an existing facility, it could fall under part 58.35(a)(3)(ii) (A) and (B), (Finding C) which states in part:

. . . The following activities are categorically excluded under NEPA, but may be subject to review under authorities listed in §58.5 . . . Rehabilitation of buildings and improvements

when the following conditions are met . . . In the case of non-residential structures, including commercial, industrial, and public buildings:

- The facilities and improvements are in place and will **not** be changed in size or capacity by more than 20 percent; AND
- The activity does not involve a change in land use, such as from non-residential to residential, commercial to industrial, or from one industrial use to another. (Emphasis added)

See **Exhibit 8-H.6** for a sample letter for a finding of “Categorical Exclusion” under 24 CFR Part 58.35(a)(3)(ii) (A) and (B).

If the project involves new construction, if size or capacity will be changed by more than 20 percent, or if a change in land use is involved, a full environmental assessment (Finding D) will likely be required. See **Exhibit 2-M** for the Consolidated Environmental Assessment form. For example:

- A project involving construction of a new building for a start-up firm will generally require a complete environmental review (Finding D);

Note: Even if CDBG-ED funding is for working capital and/or equipment, a complete environmental review will be required if the new construction was not completed prior to the CDBG-ED award.

- A project that proposes to provide working capital to an existing firm to help it retain its existing workforce, and involves no major modifications to the facility, may be determined to be exempt from environmental review after initial environmental review procedures have been conducted (Level B finding);
- A project that proposes to expand its existing 20,000 square foot commercial facility by 3,000 square feet (15%) may be determined to be categorically excluded after initial environmental review procedures have been completed (Level C finding); or
- A project in which the business plans to renovate its 30,000 square foot building and add on an additional 9,000 square feet (30%) generally requires a complete environmental review (Level D finding).

A complete copy of 24 CFR Part 58 is available from the MDOC. Please contact the your CDBG-ED liaison for a copy or with any questions concerning the environmental review process.

NOTE: It is absolutely essential that the applying local government and the assisted business not incur ACTIVITY costs or obligate funds, which are intended to be reimbursed with CDBG-ED funds prior to the date that all contract start-up conditions (Section 14, Special Conditions, of the contract) including signing the loan agreement if applicable, are satisfied by the local government and approved in writing by the

MDOC. The local government may incur ADMINISTRATIVE costs as directed by the Department, from the date of CDBG-ED award.

C. Chapter 3 – Procurement Standards

All of the provisions contained in Chapter 3, Procurement, apply to a local government's procurement of goods or services that will be paid for in whole or in part with CDBG-ED funds. The procurement requirements do not apply to private sector procurement of goods or services even if they are to be paid for with loaned or granted CDBG-ED funds that have been provided by the local government. For procurement of grant administration services, see **Exhibit 8-J**.

D. Chapter 4 - Financial Management

Local governments must comply with all of the applicable financial management requirements contained in Chapter 4, Financial Management. A private sector entity would not have to comply with the financial management requirements in the chapter, except as provided for in the chapter and in any agreements between the local government and MDOC and between the local government and the assisted private sector entity. There are specific requirements related to the drawdown of funds by the local government for economic development projects, program income and revolving loan funds, and other financial requirements that will apply to the local government and the assisted private sector entity. These requirements will be discussed later in this chapter.

A management plan will have to be completed, as part of project start-up conditions that outlines responsibilities of all parties during the contract, including financial management. Please refer to **Exhibit 8-L** for CDBG-ED projects. For construction projects, please refer to **Exhibit 1-B** for management plan formats.

E. Chapter 5 - Civil Rights

All civil rights requirements apply to the local government even if the requirements are not directly related to economic development, such as adopting and publicizing a fair housing resolution by the local government. The local government must obtain information from the business in order to comply with some direct benefit reporting requirements discussed in Chapter 5, Civil Rights, and Chapter 13, Project Closeout. The assistance agreement between the local government and the business will contain sections requiring the business to comply with federal nondiscrimination laws. The hiring and training plan also must contain a provision that the business will comply with equal opportunity and nondiscrimination laws.

F. Chapter 6 - Labor Standards

Federal Davis-Bacon wage and labor requirements should be given careful consideration when planning CDBG-ED funded economic development projects. Davis-Bacon wage rates could apply to some economic development projects. Projects that include construction, remodeling, site development, equipment installation or other similar activities involving the use of CDBG-ED funds for contracted labor and services will usually have to comply with Davis-Bacon requirements. The additional costs associated with Davis-Bacon wage rates should be considered when calculating project costs and when obtaining estimates from potential contractors.

All construction contracts funded in whole or in part with CDBG-ED funds must include federal labor standards provisions. This includes contracts funded either with CDBG-ED funds directly by the local government or with CDBG-ED funds provided to the business. The local government must ensure that the business complies with the following federal labor standards laws: Davis-Bacon Act, Copeland Anti-Kickback Act and the Contract Work Hours and Safety Standards Act.

The Davis-Bacon Act requires that workers on federally funded construction contracts receive no less than the federal prevailing wage as established by the U.S. Department of Labor. The law applies to most construction, alteration and renovation contracts involving more than \$2,000 in labor costs.

The Copeland Anti-Kickback Act requires that workers be paid weekly and that their employer not illegally charge them for the privilege of working. Contractors and subcontractors must maintain complete employment and payroll records, and submit weekly payroll records to the local government, even if the construction is procured and contracted by the assisted private sector entity, using CDBG-ED funds in whole or in part, to pay for the contracted services.

The federal Contract Work Hours and Safety Standards Act specifies overtime compensation for workers.

Chapter 6, Labor Standards, and Chapter 9, Public Facilities, contain a much more detailed description of the requirements that will be applicable to economic development projects that include construction activities.

Davis-Bacon wage rates would not apply in cases where:

- A contractor who bids successfully on the project is a sole proprietor and will perform the work entirely him/herself, without additional employees (**Note:** sole proprietors still must submit weekly payrolls that indicate that he/she is the owner and the hours she/he worked)
- Equipment installation is limited to the equivalent of plugging it into the electrical system or placing it on the floor with only minor attachment work required
- Equipment installation by the company selling the equipment is a condition of the equipment's guarantee

Davis-Bacon wage rates do not apply to the business' existing work force or to newly hired low and moderate-income persons when they are occupied at their regular duties as described in their regular job description. The entity to receive assistance may utilize its existing labor force for minor, incidental work on project activities only when no separate contracts to perform the work involved in the project activities are entered into by the entity and its existing work force. The workers cannot conduct work, which would be required to be done by licensed or certified persons (e.g., electricians, carpenters, or plumbers).

There are many combinations of activities and funding sources in CDBG-ED economic development projects that may or may not trigger federal labor standards. Consult with the CDBG-ED Program Specialist when in doubt about when the project activities will trigger federal labor standards. Often, the local government and the business may not know exactly in advance which contracts or activities could trigger federal labor standards for the project. Assistance agreements, therefore, should include the appropriate federal labor standards compliance sections if there is a possibility that some CDBG-ED funded activities could trigger compliance actions.

G. Chapter 7 - Acquisition and Relocation

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended, **applies to any acquisition of real property if federal funds are involved in any part of the project cost.** "Voluntary" acquisitions are not subject to the stricter provisions of the Uniform Relocation Act. Contact your CDBG-ED liaison to determine the project scope and whether the acquisition is voluntary or non-voluntary.

H. Chapter 9 - Public Facilities Construction Management

This chapter applies to economic development projects that involve publicly contracted construction by the local government. It does not apply to private-sector contracted facility construction. Chapter 9 would apply, however, to the development of an industrial park that involves the construction of related water, sewer, and street improvements by the local government using CDBG-ED funds.

I. Chapter 11 – Involving the Public

Both the local government and the business should carefully consider how they represent the project to the general public and interested parties. The local government should keep proprietary information secured and maintain the confidentiality of business financial statements received from the business.

J. Chapter 12 – Project Monitoring

CDBG-ED program personnel will conduct a monitoring visit to the local government at least once during the implementation of the project. The monitoring agenda will include a visit to the local government, the project manager, if applicable, and the assisted business, with a review of specific loan documentation and other records. The local government and its project manager, if applicable, will have the responsibility to monitor the process and

compliance actions of the business during the project. After MDOC closes out the project, the local government will still have to monitor the repayment of the loan made to the business.

Note: Not all of the monitoring items found in Chapter 12 may apply to economic development projects. Your CDBG-ED liaison will provide you with additional guidance before the monitoring visit.

K. Chapter 13 - Project Closeout

This chapter applies to all local governments. The business must provide sufficient information for the local government to fill out the closeout certifications and reports.

L. Chapter 14 - Project Audits

All expenditures of CDBG-ED funds by the local government and private nonprofit sub-recipient are subject to the requirements and threshold limits for audits contained in OMB Circular A-133 and the “Common Rule” (“Administrative Requirements for Grants and Cooperative Agreement to state, local, and federally reorganized Indian Tribal Governments”). Generally, entities that **expend** \$500,000 or more in a fiscal year in Federal funds from **all** sources must have a single or program specific audit conducted for that year. For local governments retaining and subsequently re-loaning program income, the program income is considered federal funds and must be counted as part of the total federal expenditures.

Private sector entities (i.e., businesses receiving loans) do not have to be audited. The local government, however, must require financial documentation and reports from the business, including documentation of the propriety of the use of CDBG-ED funds by the assisted entities and periodic financial statements.

III. LOCAL GOVERNMENT RESPONSIBILITIES

In addition to all of the applicable compliance actions and procedural steps contained in the chapters discussed above, the local government and the assisted business must follow the steps outlined in the following sections.

A. Prepare the MDOC Grant Contract

As part of the project start-up process, MDOC and the local government will work together to prepare the grant agreement or contract. The grant contract is the legal document that governs the administration of the grant and includes the following items:

- The amount of CDBG-ED funds to be provided;
- The scope of services;
- A detailed budget for the CDBG-ED funds and any other funds involved in the project;
- The schedule for implementation of project activities and the scope of work to be completed; and
- The general and special terms and conditions associated with the grant.

The negotiation process will include fine-tuning the project budget and implementation schedule, identifying any special conditions that will be included, and defining the key elements of the project in specific terms. If major changes in the project are proposed when the contract is being developed, MDOC will consider whether the modifications are substantial enough to require reevaluating the project by the loan review committee. Each provision is legally enforceable and designed to spell out the respective obligations of MDOC and the local government.

A sample contract for economic development is included in **Exhibit 8-A**. The CDBG-ED liaison assigned to your project will prepare the MDOC contract. The contract will reflect the key elements of the project as described in the original CDBG-ED application. Local officials should pay particular attention to the sections addressing grant amount, scope of work, conditions, budget, and project implementation schedule.

The MDOC recommends that the local government's attorney review the contract to ensure that it is consistent with the community's legal authority and interests. Any concerns should be communicated to the CDBG-ED liaison assigned to the project. The CDBG-ED liaison will work with the local government on any necessary modifications before the contract is signed by the MDOC Director, and the local government's chief elected official or executive officer. Three copies of the contract require original signatures. The local government will receive one completely signed copy, and the MDOC will retain two copies. **The contract is not in effect until the local elected official or city manager and the MDOC Director have signed it.**

NOTE: No CDBG-ED funds will be released to the local government until a grant contract is fully executed and the local government complies with all required contract start-up conditions.

B. Prepare a Grant Assistance Agreement or Loan Agreement

An assistance or loan agreement must be executed for all economic development projects. Generally, the assistance agreement involves a loan to a for-profit or non-profit entity, or a grant to a non-profit entity for indirect assistance such as the construction of supporting public facilities in an industrial park. An assistance agreement to a for-profit entity normally takes the form of a loan agreement. Each type of assistance agreement involves different considerations. However, all assistance agreements commit the business to the specific scope of activities, to compliance with the hiring and training plan, and to compliance with other applicable requirements.

The local government must submit copies of all draft assistance agreements to MDOC. **No loan agreement will be executed until the draft is sent to MDOC and the contract's CDBG-ED liaison has reviewed it.** The loan agreement is not in force or effect until the business and the local government representative have signed it.

NOTE: After the loan agreement is signed, no amendments can be made to it during the CDBG-ED grant contract period without prior written approval from the MDOC.

An exhibit with required CDBG-ED clauses that is to be attached to the loan agreement is included in **Exhibit 8-B, Exhibit 8-C, and Exhibit 8 C-1** contains sample assistance agreements. **Exhibit 8-C** is for a non-profit entity that can be used for projects involving indirect assistance (industrial parks, incubators, public facilities, etc.). **Exhibit 8 C-1** is a grant assistance agreement for a customized training project. It is to be used between the local government or local development organization, and the assisted business. It is very important that the local government's attorney review and approve all assistance agreements involved in the project. The MDOC recommends that the local government consider hiring an attorney familiar with loan documentation requirements if its attorney does not have loan experience. Administration funds can be used to help cover the cost.

NOTE: No CDBG-ED funds will be released to the local government until the loan agreement is signed and the local government complies with all contract start-up conditions.

C. Obtain Final Approval of the Hiring and Training Plan

A Hiring and Training Plan is to be submitted with the application for funding. Before funds can be released for a project, the MDOC must review and give written approval of the Hiring and Training Plan. In many cases, some modifications must be made to the Plan. The

revised Plan must then be signed by all responsible parties and resubmitted to the MDOC for approval.

The assistance agreement between the local government and the business must contain conditions regarding the hiring of LMI persons. The business must show substantial compliance with the hiring and training plan and a "good faith" effort toward accomplishing the hiring goals set out in the assistance agreement before the project can be closed out. To comply with federal requirements, the MDOC must ensure that performance goals are achieved; therefore, the assistance agreement will contain a penalty clause for noncompliance with the hiring and training plan that could result in the recovery of grant funds from the business or the local government recipient.

Local governments and assisted entities must take into consideration equal opportunity and nondiscrimination laws to ensure that women and minorities are not excluded from participation in, denied the benefit of, or subjected to discrimination under any program or activity funded in whole or in part with CDBG-ED funds.

At a minimum, an acceptable hiring and training plan (**Exhibit 8-G**) should contain the following:

- A breakdown of jobs to be created or retained, indicating the percentage which are full-time, part-time, skilled, semiskilled, or unskilled;
- A discussion of the actions to be taken to ensure that the positions created will be made available to persons of low and moderate income;
- A breakdown of jobs to be created, indicating the job titles and descriptions and the rates of compensation. For applications proposing positions involving less than full-time employment, an estimate must be included of the number of hours to be worked each week or months to be worked each year for each position;
- A timetable for creating the jobs, the total number of persons to be hired, and number of LMI persons to be hired. The Department will generally use the number of jobs to be created or retained within a period of two years from the date of grant award;
- An assurance that the business will comply with equal opportunity and nondiscrimination laws;
- Procedures for the outreach, recruitment, screening, selection, training and placement of workers that will ensure maximum access for local residents, particularly persons of low and moderate income;
- A description of the training curriculum and resources, if applicable;
- Written commitments from any agencies or organizations participating in the implementation of the plan; and

- A written commitment from the business to comply with the plan.

Minimum job requirements should not exceed the equivalent of a high school education in order to be counted as a job opening available to LMI persons. If job qualification requirements exceed the equivalent of a high school education, training can be provided to enable otherwise unqualified persons to qualify for the position. The jobs that are to be created must be physically accessible to the LMI population within a reasonable geographic area.

D. Obtain Final Approval of the Hiring and Training Plan for Customized Training of Employees

In addition to the information above, the Hiring and Training Plan for a business receiving a grant for customized employee training must contain a signed assurance from the company that in the event the company ceases operation within the contract period, the company will reimburse the local government for the full amount of the labor-training grant. The Hiring and Training Plan for Customized Training of Employees becomes an attachment to the contract between the MDOC and the local government (see **Exhibit 8-G**).

E. Develop a Revolving Loan Fund Plan

CDBG-ED projects that involve the loan of CDBG-ED funds to the business must plan for the use of program income. There are a large number and variety of eligible uses for CDBG-ED funds. (See **Exhibit 8-K, Eligible Activities.**) The local government has flexibility in planning for the use of program income. Generally, local governments choose to use program income from economic development projects involving loan repayments to capitalize an economic development Revolving Loan Fund (RLF). Program income from economic development projects can be blended with program income from other CDBG-ED projects, such as housing rehabilitation, and used for eligible community development projects. The MDOC encourages local governments to use program income from economic development projects for similar purposes such as developing local capacity for packaging economic development projects and for ongoing economic development activities. Program income can be used for hiring experienced staff trained in financial analysis that can actively promote economic development for the community.

The Department allows program income to be retained by the local government if the local government has developed an adequate plan for the expenditure of these funds. The local government must submit to the Department, for approval, a plan for the ongoing use and financial administration of any program income. The plan must be submitted **before** the Department will release funds and before the business begins making loan repayments. It is very important that the local government demonstrate that it has, or will quickly develop, the capacity to set up and manage an RLF for future eligible community development projects.

“Program Income” is any income earned by a local government from CDBG-ED-supported activities such as repayments of principal and interest to a local RLF for an economic development project. An “RLF” is the administrative umbrella for the re-use of program income in the making of low-interest community loans that is managed according to a written

set of guidelines developed by the community. Revolving loan funds are a subset of program income that has been set-aside in a separate fund with a separate set of accounts. In the case of a CDBG-ED project, the RLF is established to carry out eligible economic development activities that in turn generate program income through loan repayments and interest earned. Revolving loan funds are allowed to earn interest and grow. The funds do not have to be drawn down while the project is open. Theoretically, the revolving loan fund becomes a fund from which monies are continuously expended, replenished, and again expended.

The MDOC can recover program income from local governments if the program income is not going to be used on the same project that has generated program income and if the local government does not develop a satisfactory program income plan. For further guidance you may request from MDOC the *CDBG-ED Program Income and Revolving Loan Fund Manual* published by the Montana Department of Commerce in 1996. Contact your CDBG-ED liaison for assistance. **Exhibit 4-H** also has additional information on program income.

1. State and Federal Requirements for Program Income Plans or Revolving Loan Fund Plans

Federal regulations and guidance from the U.S. Department of Housing and Urban Development require that program income received by a local government before the project is closed out be used in accordance with the provisions of Title I of the Housing and Community Development Act of 1974, as amended. All regulations and requirements that applied during the term of the project would apply to program income received before closeout.

Any program income received by the local government after closeout is subject to the provisions of Title I of the Act until all open CDBG-ED projects are closed out by the local government, if any. Program income received after a project is closed out is also subject to the provisions of Title I. Montana CDBG-ED Application Guidelines require that all program income received be expended on CDBG-ED eligible activities, benefit 51% LMI persons, and be accounted for. The local government must continue to maintain the following records and information:

- Sources of program income including interest earned;
- Dates and amounts of program income receipts and disbursements;
- The CDBG-ED-eligible activities funded with program income;
- For program income received before all open CDBG-ED projects are closed out, records documenting compliance with Title I requirements.

In addition, the local government must:

- Submit the Loan Portfolio Data (LPD) report once a year, for period ending December 31. Receipts of loan payments and expenditures must be reported in addition to project specific data. This report should include the entire loan fund's activity and balance for primary and secondary loans. (See **Exhibit 8-I**);

The local government must develop a process for managing, accounting and reporting program income, which must be incorporated into the Program Income Plan, or RLF Plan. In addition, the local government must develop a process for selecting eligible firms that will likely maximize the benefits received from the use of program income. It will be necessary for the local government to develop guidelines for the selection of the best applicants and for the management of economic development projects selected for funding. Local governments must develop the capacity for handling the complexities of managing economic development RLF's. Otherwise, the risk involved in lending public funds becomes considerably greater.

The MDOC recommends that local governments base their RLF guidelines on the *Application Guidelines for the Community Development Block Grant Economic Development Program*. The local government can select the sections that best apply to their situation and economic development goals. Keep in mind that if Title I requirements (**Exhibit 8-K**) apply to the use of program income in the revolving loan fund, the local government must use at least the equivalent of the Montana CDBG-ED guidelines and also comply with the CDBG-ED requirements contained in this manual.

The local government should select a loan review board that will be responsible for publicizing the availability of economic development funds for local projects, for applying the selection criteria when choosing the best applications, and for managing the loan portfolio. Local governments are encouraged to include bankers, certified public accountants, lawyers, the business community, as well as include the general public in the loan review board activities.

2. State Guidance for CDBG-ED Revolving Loan Funds Administered by a Local Government

Program income (loan repayments) received by a local government after closeout must continue to be used in accordance with the provisions of Title I. As such, all regulations and requirements that applied during the term of the project will apply to the program income received after closeout

a. Before Project Closeout – All Years:

- Program income received by a grantee before closeout must be used in accordance with the provisions of Title I. As such, all the regulations and requirements that applied during the term of the project will apply to the program income received before closeout. For the most part, this means that program income must be used for eligible CDBG activities, and that a minimum of 51% of the funds must be used for activities that are clearly designated to meet identified needs of persons of low and moderate income.

b. After Project Closeout -- For the years of 1992 and prior:

- The MDOC encourages the use of program income for CDBG eligible activities that assist a minimum of 51% low and moderate-income persons.

- Program income should be expended on activities as specified in the local government's program income plan and/or closeout agreement.

c. After Project Closeout -- For the years of 1993 and Later:

MDOC has developed the following proposed policy for expenditure of program income after close-out which will meet the federal national objective of benefiting low and moderate income persons (LMI) and allow local governments some flexibility with their program income:

- For CDBG economic development activities: a maximum of 18% would be allocated to an administration fund and a minimum of 82% allocated to an activity fund for each state fiscal year.
- Program income should be spent on CDBG eligible activities that principally benefit 51% low and moderate-income persons, the original intent of the program, but allows some flexibility to carry out eligible CDBG activities in those communities that are not 51% LMI community-wide.

All program income received by a grantee after closeout must continue to be used in accordance with the provisions of Title I (Davis Bacon wage rates, environmental review, etc.). As such, all regulations and requirements that applied during the term of the project will apply to the program income received after closeout.

If a community has a CDBG-ED grant that is not closed out and receives a new CDBG-ED grant, the community may be required to expend un-obligated program income from the earlier CDBG-ED project on activities under the new CDBG-ED project before the community can request funds from its new grant. This would not apply if the funds have been set-aside in a separate revolving loan fund account and have been allocated for specific projects. **However, local revolving loan funds must be substantially disbursed before additional funds are requested from the MDOC.**

In addition, for projects funded in 1993 or later, the MDOC has determined that:

- To maintain a minimum level of funding for future borrowing needs, repayments of principal must be placed in the RLF for relending. Repayments of interest, and interest earnings on loan repayments deposited into an interest-earning account, may be used either for relending or for administrative activities.

Exhibit 8-D is a sample set of guidelines for an economic development revolving loan fund that MDOC adapted from an actual CDBG-ED-funded project for a small town. The local government may follow this sample and design its guidelines with its own needs in mind. Please contact your CDBG-ED liaison for more examples of RLF Plans from across the state.

⇒ According to federal regulations, program income never loses its federal identity. When loans are repaid, all HUD Title I requirements, such as environmental review and Davis-Bacon wage rates must be met in any subsequent reuse of these funds. The only exception is:

- When loan repayments are made to a qualified nonprofit community development organization.

That is, when program income is managed by a non-profit, it is no longer considered program income as it is with a local government. Prior to project closeout, the local government is the recipient of the CDBG-ED funds and Title I applies to all activities. After project closeout, if program income is managed by a non-profit, Title I does not apply to the non-profit's activities.

3. State Guidance for CDBG-ED Revolving Loan Funds Administered by a Local Development Organization (LDO)

Title I of the Community Development Act (the Act) allows loan repayments made to a qualified nonprofit LDO to be free of CDBG-ED program income requirements. That is, loan repayments made to a nonprofit LDO are not defined as program income and therefore are not subject to federal CDBG-ED requirements. A qualified nonprofit LDO is defined under Section 105(a) of the Act. This change was made to the Act in 1992 and was incorporated into the regulations as of February 6, 1995. Therefore, this will apply to program income generated from CDBG-ED projects funded with 1995 and later funds.

In this scenario, the unit of local government gives the CDBG-ED funds to a regional loan fund administering entity, the nonprofit LDO. **There must be a sub-recipient agreement between the LDO and the unit of local government** (see **Exhibit 8-M, Sample Sub-recipient Agreement**). **The sub-recipient agreement MUST have been submitted with the application.** The LDO lends the funds to businesses in its service area or to cities or counties specified in the sub-recipient agreement. The business would repay the loan back to the administering entity's loan fund. According to 24 CFR Part 570.489(e)(2)(ii), this income would not be defined as program income. The loan repayments are considered miscellaneous revenue and would not be subject to CDBG-ED program income requirements. However, the MDOC encourages the following:

For CDBG economic development payments made to a qualified non-profit:

Payments made to a community development organization that uses the funds for continued economic development activities do not have to meet any Federal requirements. However, the local government can still establish requirements for re-use of the funds, and require some CDBG requirements to be followed through grant agreements between the local government and the community development organization. A revolving loan fund plan must be executed that is agreeable to the local government. The local government must also execute a sub-recipient agreement with the community development organization for management of the revolving loan fund.

⇒ The Department encourages community development organizations to continue to use loan proceeds for CDBG-ED eligible activities that benefit 51% low and moderate-income persons, and to follow activities specified in the revolving loan fund plan.

F. Show Benefit to Low and Moderate Income (LMI) Persons

It is the responsibility of the local government to document the proposed benefit to low and moderate-income (LMI) persons at the time of application. In addition, the local government must monitor this for the duration of the MDOC contract and document the actual benefit at the time of project closeout.

All CDBG-ED projects are required to meet the Congressional National Objective of benefiting LMI families. LMI families are defined as those families whose income does not exceed 80% of the county median income for the previous year, or 80% of the median income of the entire non-metropolitan area of the State of Montana, whichever is higher. Contact your CDBG-ED liaison to get the most current HUD income tables.

For economic development activities to meet this National Objective, the local government must demonstrate a benefit to LMI in one or more areas listed below. The activity must:

- Be carried out in a neighborhood or community where 51% or greater number of LMI persons reside (contact your CDBG-ED program liaison for activity eligibility);
- Employ people, a majority of who qualify as LMI persons;
- Make training available to LMI persons to help them qualify for higher skilled employment; or
- Engage in advertising and recruitment efforts targeted to LMI persons.

To document the benefit to LMI persons, determine which of the four activities listed above applies to the project. The local government must determine the best method by which to substantiate this determination and provide appropriate documentation. Possible methods include:

- Identifying the specific neighborhood or community boundary and conducting an income survey of the project's intended beneficiaries;
- Obtaining income certifications from individuals hired;
- Documenting the type of training to be provided; and
- Documenting efforts to advertise and recruit LMI.

Area-wide Benefit (City or County-wide Benefit)

Fifty-one percent (51%) of all persons living within the city or county boundaries must be LMI. This percentage should be documented by current program year, HUD income tables provided by the CDBG-ED liaison. A fairly current income survey for the area may also be used if the documented methodology complies with MDOC survey requirements. (Contact your CDBG-ED program liaison for more information on area-wide benefit.)

Limited Clientele

Benefits must be provided exclusively to a **clearly** defined, specific clientele. If a population is targeted to be the beneficiary of a project, the project scope must demonstrate that the benefits to be provided to that population are **not** available to all residents and that the targeted population meets one of the criteria below:

a. Benefit is specifically targeted to a group presumed to be 51% or more LMI, unless there is evidence to the contrary. The limited clientele definition can be applied only to those groups included under HUD regulations, which includes:

- Abused Children
- Homeless Persons
- Battered Spouses
- Illiterate Adults
- Elderly Persons
- Migrant Farm Workers
- Adults meeting the Bureau of Census' definition of severely disabled adults
- Persons living with the disease AIDS
- Migrant Farm Workers

b. Information on family size and income shows that at least 51% of the clientele is LMI (e.g., programs being operated where LMI income certification is routinely requested to allow participation in the program);

c. Benefits are limited to LMI (e.g., a nursing home whose occupancy is limited to LMI);

d. The nature of activity and location supports conclusion that clientele is 51% or more LMI (e.g., a day care operated in an inner city neighborhood, a micro-enterprise as defined by HUD, or an organization that supports micro-enterprise development);

e. Removal of architectural barriers that limit the mobility of elderly and handicapped.

The local government's project must be designed specifically to benefit LMI persons such as those groups previously identified.

Micro-enterprises

Projects that meet HUD's definition of a Micro-enterprise are automatically assumed to provide a 51% benefit to LMI persons. Micro-enterprises do not have to meet the cost per LMI job requirement. A Micro-enterprise, as defined by HUD, is a commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise. A Micro-enterprise

under HUD's definition automatically meets the 51% low-moderate income national objective if the income status of the assisted micro-enterprise owner is LMI. That person is presumed to continue to qualify as LMI up to a three-year period after the CDBG-ED assistance is provided. This allows business owners to continue receiving CDBG-ED assistance even when they no longer qualify as an LMI household.

G. Documenting LMI Jobs Created or Retained

Local governments must ensure that methods are used to ensure preferential recruitment, hiring, and training of local workers, particularly those of low and moderate-income. When a grant is awarded, the applicant's commitment to the hiring plan is considered binding and will be incorporated in the grant agreement between the local government and MDOC.

1. All jobs must be converted into full-time equivalent positions. A full-time equivalent employee is an individual who is employed for 40 hours a week on the average or a combination of individuals whose combined hours of employment equal 40 hours per week.

Using the income certification forms, **Exhibit 8-E**, verify the number of positions currently held by LMI persons for an existing business, and project those full-time equivalent (FTE) LMI jobs to be created based on the company's hiring plan. Aside from using the HUD income tables, a person may be presumed to be LMI under certain conditions (see F. above).

Permanent, year-round jobs are the priority of the program. Only permanent jobs may be counted. Temporary construction jobs and other temporary and some seasonal jobs may not be counted. Projects involving primarily seasonal jobs are not generally acceptable under federal CDBG-ED requirements. In order to be counted, a seasonal job must be the primary occupation and the principal source of income to the LMI person for the year. This situation is very difficult to document and is not encouraged for CDBG-ED projects.

The base level of employment with a list of all current employees and job titles must be provided with the application for CDBG-ED funding to determine the actual number of new hires. For existing firms, applicants must provide employment levels for the past year. The date for determining the base level of employees will be the application submission date. Only jobs that the assisted business creates directly within a 24-month period following grant award will usually be counted toward this requirement. The Department cannot consider jobs created indirectly by an assisted activity (i.e., "trickle-down" jobs).

2. Fifty-one percent (51%) of all jobs created by the business during the term of the project must be filled by or made available to LMI persons. This applies even if more jobs are created than were originally projected.

For projects involving the retention of jobs, the income levels should be documented for the prior year's income of the family. The verification forms should be completed no more than 30 days before submittal of the application. The application must provide clear and objective evidence that, in the absence of the CDBG-ED assistance, the jobs will be lost. The business will have to commit to filling as many new job openings from turnover and job creation as is

reasonably possible with LMI persons. The full application must include a complete listing of all existing jobs by title, race, ethnicity, gender and handicapped status. The application must indicate which positions are currently held by LMI persons. The business should provide an estimate of its expected job turnover rate during the next two years, especially if job turnover will be counted toward the LMI benefit percentage.

Businesses claiming retention of jobs must submit with the full application documentation of existing employees eligible to be considered LMI by using the income verification form (Exhibit 8-E) and job tracking form (Exhibit 8-F).

3. Tracking jobs for customized training grants. Businesses must track training expenses for each position assisted with CDBG-ED funds.

Exhibit 8-Q is a form that can be used to track individual training expenses for each trained employee. Businesses must document matching training funds 1:1 for each CDBG-ED dollar expended. For example, if a company sends an employee to a local college to take a course for related training, CDBG-ED would pay for half of the training costs. The business would pick up the other half. A completed Exhibit 8-Q or its equivalent would have to be submitted with each request for CDBG-ED funding. Businesses can request reimbursement for training expenses at the end of each employee's training or probationary period. Trained employees must be paid at least \$13.00 when training is completed.

4. Local governments must ensure that they maintain complete hiring records. Local governments must also ensure that the assisting agency and the assisted business maintain complete records. Federal regulations and reporting requirements require that racial, ethnic and gender characteristics information be maintained for all job applicants as well as new hires (Exhibit 8-E).

Making Jobs Available to LMI

The best situation, and one that MDOC highly recommends, would involve requiring that the positions considered available to LMI persons actually be filled by LMI persons. This approach is more easily documented and defensible. When this is not possible, the business must be able to document that it gave first consideration to LMI persons during the hiring process. First consideration means that a business gives objective consideration to the employment of LMI persons. "Objective consideration" must involve the business at least interviewing a sufficient number of LMI persons so as to provide the maximum opportunity for filling the position with LMI persons.

The U.S. Department of Housing and Urban Development (HUD) developed the "first consideration" approach with the expectation that, in most instances where it is applied, the outcome will be that more than 51% of the persons hired will be LMI. The business will be required to consider a sufficient number of LMI job applicants to meet the intent of this requirement. The local government must ensure that there is adequate documentation available to show what jobs were created, what process was used for "first consideration," which LMI persons were considered for such jobs, and which of those persons were hired.

Consult the Business Resources Division CDBG-ED staff if uncertain whether a job to be created would be considered "made available to" low and moderate-income persons.

HUD has accepted retained jobs actually held by LMI persons, considering their family income and size, as jobs made available to LMI persons.

H. Submit Requests for Drawdown of CDBG-ED Funds

After all start-up activities have been completed and all MDOC contract conditions have been released in writing, the local government can make a request for funds from MDOC. Chapter 4, Financial Management, explains the procedures that are applicable to the drawdown of funds for all CDBG-ED projects. In addition to the procedures and requirements contained in Chapter 4, the local government must submit additional information for economic development projects.

When a business requests CDBG-ED funds, the local government must obtain documentation from the business about the purposes for which the CDBG-ED funds are to be used. The local government must determine the propriety of the proposed use of funds before submitting a drawdown request to the CDBG-ED liaison. The disbursement of CDBG-ED funds to the local government and the business must be tied to the actual need for the funds. The local government must ensure that the CDBG-ED funds will be used for the activities and purposes described in the MDOC contract and in the assistance agreement. The local government should be sure that the budget line items are equal to or greater than the amounts requested. For example:

- If the business is requesting funds for working capital, the business must submit copies of bills, vouchers, payment requests, orders, payrolls, etc., which substantiate the amount requested. Projected working capital needs may be used provided the local government or its project administrator later reconciles the projected needs with actual working capital expenditures. Back up documentation must be maintained for all projected and actual expenditures.
- If the request for CDBG-ED funds is used for machinery or equipment, the business must submit documentation describing the machinery or equipment being purchased and the bill or order form showing the amount incurred.

NOTE: Be sure that the documents supporting the costs incurred are dated after the MDOC authorization to incur costs for project activities. Copies of the supporting documentation must be submitted with the drawdown request to the CDBG-ED liaison.

I. Submit Applicable Reports

The CDBG-ED grant contract and the assistance agreement will contain minimum reporting requirements that apply to the local government and the business. The local government must obtain the necessary information from the business.

1. The local government, or its project administrator, must submit the following reports to the MDOC quarterly during the project until it is closed out:

- General progress reports must be submitted to the MDOC within 30 days of the end of the quarter. If a drawdown request for funds is during a given calendar quarter and a progress report accompanies the drawdown request (see Chapter 4, Financial Management), a separate general progress report is not required.
- Hiring and training plan progress reports (Exhibit 8-F) should be submitted to the CDBG-ED liaison quarterly, and more often if requested. For each person hired or retained during the term of the project, the business must provide the name, address, date of hire, job title, information indicating whether the job is full-time or part time and permanent or seasonal, rate of pay, household size and income, and any applicable information required for direct benefit activities in Chapter 5, Civil Rights. Part-time jobs must be converted to full time equivalents. Racial and ethnicity category information must also be collected and reported quarterly (**Exhibit 8-E**).
- Evidence that the funds committed as match by the business in the original application for the CDBG-ED funds are being expended on the project (bank statements, canceled checks, deed transfers, loans forgiven by investor, new investments, etc.). Matching funds should be spent on a pro rata basis with the CDBG-ED funds.

2. The local government, or its project administrator, must submit the following reports to the MDOC during the implementation of the project until it is closed out:

- Financial status reports that include at least the balance sheet and a profit and loss statement of the business for the period, at least twice per year;
- Business plan reports that discuss the business's progress toward achieving the goals and objectives contained in the original application submitted by the local government, at least once per year;
- Hiring and training plan progress reports, quarterly – if not submitted with requests for funds;
- Annual financial reports of the business, with disclosure notes, reviewed by a certified public accountant.

3. The local government, or its project administrator, must submit the following report annually to MDOC before and after project closeout:

- Loan Portfolio Data (LPD) sheet (Exhibit 8-I) that tracks the business's activities, as of December 31 each year. The local government must begin submitting the LPD when loan repayments start, and continue to submit the LPD to the MDOC after closeout on an annual basis. Loan activity for the entire revolving loan fund must be included in the annual report for primary and secondary loan activities.

Depending on the type of project and the number and complexity of any problems that may arise during the term of the project, the CDBG-ED liaison may require the local government to submit reports more frequently or provide additional reports. It is very important that the local government reviews the information submitted and retains all copies of reports in the project files, especially the hiring and training plan reports and the financial statements. Based on the information contained in the reports, the local government and the CDBG-ED liaison can determine how often and how closely the business should be monitored. The local government should monitor the business periodically during the project.

The assistance agreement and the CDBG-ED grant contract contain a penalty clause that applies to the hiring goal. If the hiring goals and timetable committed to by the business in the final hiring and training plan are not met during the term of the project, the MDOC may recover CDBG-ED funds in proportion to the shortfall in hiring. If at least 51% of the total jobs created or retained are not held by, filled by, or made available to LMI persons, the local government may be required to repay the total grant amount to the MDOC. The local government needs to take steps to monitor the progress of the assisted business' hiring and training goals, and ensure that reporting requirements are met.

J. Review Quarterly Financial Statements

The local government should have someone who is trained and experienced in analyzing financial statements review the periodic financial reports. It is essential that any financial problems the business may experience during the term of the CDBG-ED project (and where CDBG-ED funds have been loaned, during the term of the loan) be identified as early as possible. If problems are detected, the local government can begin to negotiate with the business and help resolve them, if possible. A business cannot hire employees or retain existing employees if it cannot afford to pay them. A business obviously cannot repay a loan if it does not have sufficient cash flow available to cover the debt service.

The CDBG-ED liaison and the Business Resources Division's Regional Development Officers will also review the financial statements at least biannually and more often if conditions warrant, or if the local government requests assistance with a problem.

It is important to keep in mind that a business will often show losses during a start-up phase or when expanding. That is, of course, a common reason the business sought CDBG-ED assistance to begin with. The primary purpose of the CDBG economic development category is to provide financial or other supportive assistance to for-profit and non-profit entities. One requirement of the CDBG-ED program is that any CDBG-ED assistance to a for-profit entity must be determined to be appropriate and that the assistance has not "unduly enriched" the business. A for-profit business must be able to show that the CDBG-ED funds are needed as a last resort and that the funds requested are not available from other private and public sources. The key problem, therefore, is that the for-profit entity that receives CDBG-ED assistance is often only marginally viable.

It is very difficult to determine how bad the financial condition of a business can get before serious problems arise. It is essential that the local government communicate frequently and

openly with the business and to assure management that the local government is willing to help work out problems.

Listed below are indicators that can help the local government determine when financial troubles may be occurring or are likely to occur in a for-profit entity (or other business):

- Actual sales (or other revenues) do not meet projections;
- The hiring goals and schedule are not being met;
- Profits are continually low or negative;
- The business plan is not being followed by the business or goals are not being met;
- Operating cycle trends show significant changes from what were projected;
- Net equity and retained earnings decline;
- Liquidity ratios (assets in proportion to liabilities) indicate that the firm may be becoming insolvent (assets are becoming lower in proportion to liabilities and working capital declines);
- The matching funds are not being used reasonably in proportion to the CDBG-ED funds;
- Significant changes in management or in ownership occur;
- Changes in banks generally used by the entity;
- Management that may have been friendly and open becomes difficult to reach and unfriendly;
- Management that may have been unfriendly and aloof suddenly becomes friendlier;
- Payments on the loan are often late or missed;
- Large turnover in employees or labor relations problems occur;
- Changes occur in accounting methods or in accountants;
- Aging of accounts receivable and accounts payable indicate a trend toward later receipts of revenues and payments of bills by the entity;
- Large loans made from the entity to officers;
- Large loans made from officers to the entity;
- Large items purchased with CDBG-ED funds or with other funds are not available for inspection.

Financial analysis is an art, not a science, which requires that the local government pay close attention to trends and discuss them with the business as early as possible. The local government often has a lower security position than other lenders or providers of funds that increases its oversight responsibility. The CDBG-ED liaison should be contacted whenever the local government believes that a financial problem may be evident. The MDOC Business Resources Division has Regional Development Officers who can provide advice to the local government and the business if problems develop. The local government should also work closely with persons or entities that are providing financing for the project such as banks, investors, venture capital companies, public agencies, etc.

The local government may choose to negotiate a loan servicing arrangement with a local bank, preferably one that is also providing financing to the business. The local government may also enter an agreement with another entity, such as a local nonprofit development agency, to assist with management of the loan repayments.

K. Monitor the Business

It is the responsibility of the local government to monitor the business periodically during the term of the project. The local government must ensure that the business is complying with all applicable CDBG-ED requirements and with the terms and conditions contained in the assistance agreement. Following are some examples of key areas of concern that the local government should focus on during the monitoring visits:

- Construction progress, if applicable, should be compared with the contract implementation schedule and reports submitted by the business;
- If large pieces of machinery or equipment were purchased with CDBG-ED funds, the local government should view them and inspect their condition;
- The general condition of the facility, including inventory, should be considered, especially if renovation was included as an activity;
- Compare the number of employees present with the hiring and training plan progress report to see if any significant differences should be followed up;
- Verify income of employees;
- If the project involves labor standards, conduct interviews of the contracted employees and follow the monitoring procedures for labor standards contained in Chapter 6, Labor Standards.

CHAPTER 8

EXHIBITS

- 8-A Sample MDOC Contract**
- 8-B Supplemental CDBG-ED Conditions for Loan Documents**
- 8-C Sample Funding Assistance Agreement**
- 8-D Sample Local Government Revolving Loan Fund Plan and Loan Application**
- 8-E Calculation of Benefit to Low and Moderate Income Persons and Race/Ethnicity Category Form**
- 8-F Employment Tracking & Direct Benefit Summary**
- 8-G Sample Hiring and Training Plans**
- 8-H Environmental Review Procedures/Forms**
- 8-I Loan Portfolio Data (LPD) Report Form**
- 8-J Procurement Policy**
- 8-K Eligible Activities**
- 8-L Sample Management Plan**
- 8-M Sample Sub-recipient Agreement**
- 8-N Program Income Flowchart – CDBG-ED ED Program**

8-O Request for Payment & Status of Funds Report

8-P Employee Training Tracking Form